

FinanceFacts

A Monthly Publication on Consumer Financial Behavior

MAY 1983

Some More Observations on Financial Institutions

As discussed in last month's Finance Facts, financial intermediaries exist because they provide important financial services to both suppliers and users of funds. These services certainly appear to have proven useful to consumers, since the largest supply of intermediated funds arises from the household sector of the economy.

Total assets of the household sector have risen tremendously since World War II, the period for which detailed information is available. The table on page 3, containing estimates by the Flow of-Funds Section of the Federal Reserve Board's Division of Research and Statistics, indicates that the household sector's total assets grew from \$687 billion at year-end 1945 to almost \$11 trillion at the end of 1982. Of course, much of the apparent increase is due to inflation, but even in constant dollars household sector assets almost tripled in the post-war period through 1982 (line 4 of the table).

Lines 5 and 6 of the table show that as household assets have increased over time, the shares flowing through intermediaries have also increased. From 23 percent in 1945, the portion of total assets which were intermediated rose to almost 30 percent by 1982. Relative to financial assets alone, intermediated financial assets rose steadily over the postwar period, up from 28.3 percent in 1945 to 45.2 percent at the end of 1982. Thus, while armchair analysis might initially suggest that total asset growth would lead to a proportionally smaller role for intermediaries as households grow more financially sophisticated, this presumption is not square with the facts. Financial institutions have intermediated more house-

hold resources over time, proportionally as well as absolutely.

As with any economic phenomenon, the steadily increasing importance of financial intermediaries to the household sector arises from both supply and demand effects. Slowly increasing income and wealth have caused households to demand productive outlets for savings. However, the consumer or household sector's definition of productive includes more than just nominal return. Consumers demand a variety of attributes from their savings instruments, and this has caused financial institutions to offer a wide variety of products. The closer matching of products to needs, along with higher nominal yields over time, has raised consumers' returns from the services of intermediaries. These changes enabled the institutions to enlarge their share of the household-sector market.

Consumers, of course, save and hold assets for a variety of reasons including transactions, precautionary, speculative, old age, and estate motives. Most savers save for all these reasons and more. However, when they decide to save, consumers' second decision is to choose the asset for holding the saved wealth. Nominal yields are important, but households also demand safety and liquidity. Intermediaries offer yield, safety and liquidity in varying combinations on their liabilities.

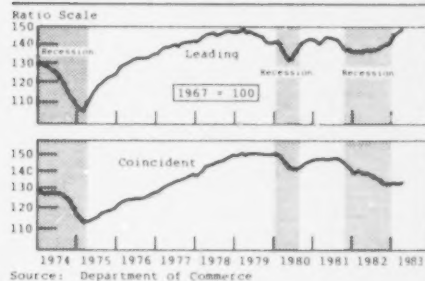
Safety or risk reduction appears paramount to the household sector, and intermediaries supply safety by offering diversification. Asset diversification would be difficult or impossible for many households, but through an intermediary the benefits of diversification are available. The intermediary simply

(text continued on last page)



LEADING ECONOMIC INDICATORS

Composite Indexes By Months 1974-1983



Source: Department of Commerce

The composite index of leading indicators increased 1.5% in March to a level of 149.8 (1967=100) according to preliminary data. Based on more complete data the February estimate remained unchanged with an increase of 1.4% and the January increase was revised slightly downward to 3.2% from 3.5% as reported last month. This index has now been increasing every month since August of last year.

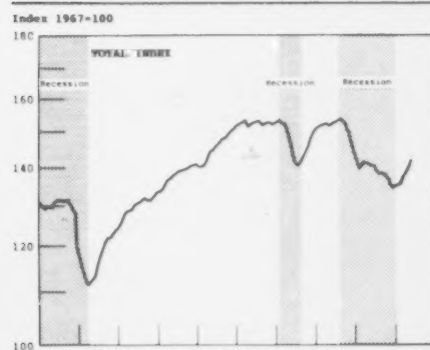
The composite index of coincident indicators, which approximates aggregate economic activity, increased 0.7% in March to 134.0 (1967=100). This index declined 0.5% in February and increased 1.3% in January.

CONSUMER INSTALLMENT CREDIT

Consumer installment credit outstanding in March increased \$2.58 billion, after seasonal adjustment to \$345.4 billion, up from a revised \$0.74 billion in February. These increases were equivalent to annual growth rates of 9% in March and 2.5% in February. For the first quarter of 1983, the annual rate of growth was 7%, compared with 4% for the full year 1982.

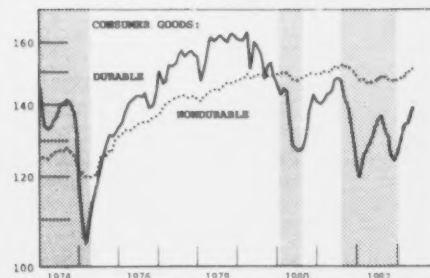
Auto credit increased \$1.22 billion and revolving credit rose \$1.18 billion. Both accounted for most of the gain in the total. They had recorded small declines in February.

Index of Industrial Production by months (seasonally adjusted) 1974-1983



INDUSTRIAL PRODUCTION

Industrial production in April increased an estimated 2.1% following advances of 1.2% in March, 0.4% in February and 1.6% in January. Gains in output in April were widespread and large advances occurred in durable and nondurable materials production. After the April increase, the level of the total index stood at 142.6 (1967=100), almost 6% above the November 1982 low, but still about 7% below its July 1981 high.



Source: Board of Governors of the Federal Reserve System

The production of home durable goods advanced more than 3% as appliances and carpeting and furniture registered strong gains. Auto assemblies edged up to a 5.9 million unit annual rate in April, from a 5.8 million rate in March. Output of nondurable consumer goods increased 1.6% as all major components rose in April.

Gregory D. Luetscher

Household Assets, Selected Years
1945-1982

(Millions of Dollars)

	1945	1955	1965	1975	1980	1981	1982
1) Total Financial Assets ^{1/}	558.6	1025.7	1922.3	3494.4	6327.2	6686.7	7178.8
A) Intermediated	158.2	299.0	673.0	1520.6	2638.6	2914.8	3247.9
a) Deposits and Currency ^{2/}	106.0	171.5	377.1	945.3	1625.3	1824.2	1986.3
b) Life Insurance Companies	39.6	69.2	105.9	166.6	222.5	232.8	243.7
c) Pension Reserves	11.3	50.5	154.8	365.7	727.1	793.8	924.9
d) Mutual Fund Shares ^{3/}	1.3	7.8	35.2	43.0	63.7	64.0	93.0
B) Not Intermediated	400.5	726.5	1249.2	1973.6	3688.4	3771.8	3930.9
a) U.S. Gov't Securities ^{4/}	67.7	69.3	79.7	152.7	293.1	329.9	344.4
b) Equities ^{5/}	297.7	596.4	1056.3	1547.4	2934.0	2937.3	3011.4
c) Other ^{6/}	35.1	60.8	113.2	273.5	461.3	504.6	575.1
2) Tangible Assets	128.1	412.8	700.0	1835.0	3468.5	3746.6	3754.4
A) Residential	79.5	260.9	466.9	1250.0	2490.2	2693.9	2664.6
a) Land	11.7	37.8	101.8	276.2	585.8	615.1	599.8
b) Structures	67.8	223.1	365.1	973.8	1904.4	2078.8	2064.8
B) Consumer Durables	48.6	151.9	233.1	585.0	978.3	1052.7	1089.8
3) TOTAL ASSETS	686.7	1438.5	2622.3	5329.4	9795.7	10433.3	10933.2

MEMO ITEMS:

4) Total Assets, 1967 dollars	1273.8	1793.8	2774.4	3309.6	3977.0	3829.0	3739.2
5) Intermediated Financial Assets Divided by Total Assets (%)	23.0	20.8	25.7	28.5	26.9	27.9	29.7
6) Intermediated Financial Assets Divided by Financial Assets (%)	28.3	29.2	35.0	43.5	41.7	43.6	45.2

Notes:

Parts may not add to totals due to rounding.

1/ Includes a small amount of financial assets of nonprofit organizations.

2/ Includes money market mutual fund shares.

3/ Excludes money market mutual fund shares.

4/ Includes Federal Agency issues.

5/ Includes equity in incorporated and unincorporated businesses.

6/ Includes state and local government securities, corporate and foreign bonds, open market paper and other miscellaneous financial assets.

Source: Board of Governors. Federal Reserve System.

(text continued from first page)

pools the limited funds of households and invests them in a diversified portfolio of assets. In contrast, liquidity, or ability to convert an asset rapidly into money at low cost, is demanded by households for some assets but not all. In particular, households require liquidity for transactions and precautionary-oriented savings, but much less liquidity is needed to satisfy old-age and estate motivations for asset holding. For this reason intermediaries offer both highly liquid products such as deposits and less liquid assets like

life insurance and pension reserves. Ultimately, differences in managing the financial intermediaries providing short term and long-term products have given rise to the chief distinction among financial institutions dealing with consumers. Historically, at least, the financial institutions supplying the liquid products for consumer asset holdings have been known as depository institutions; the ones supplying the less-liquid products have been known as insurance-type intermediaries.

Thomas A. Durkin

American Financial Services Association

1101 Fourteenth St. N.W.
Washington, D.C.
20005